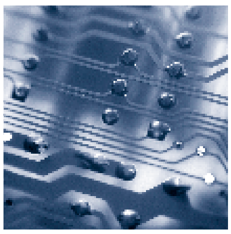

CONSOLIDATED FINANCIAL STATEMENTS

2005 | TORNOS HOLDING S.A.

TORNOS HOLDING S.A., MOUTIER
GROUP AND HOLDING FINANCIAL STATEMENTS 2005

Report of the group auditors
to the general meeting of

Tornos Holding S.A., Moutier

As group auditors, we have audited the consolidated financial statements (income statement, balance sheet, statement of changes in shareholders' equity, cash flow statement and notes) of Tornos Holding S.A. for the year ended 31 December 2005.

These consolidated financial statements are the responsibility of the Board of Directors. Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We confirm that we meet the legal requirements concerning qualification and independence.

Our audit was conducted in accordance with Swiss Auditing Standards and with the International Standards on Auditing, which require that an audit be planned and performed to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement. We have examined on a test basis evidence supporting the amounts and disclosures in the consolidated financial statements. We have also assessed the accounting principles used, significant estimates made and the overall consolidated financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements give a true and fair view of the financial position, the results of operations and the cash flows in accordance with the International Financial Reporting Standards (IFRS) and comply with Swiss law.

We recommend that the consolidated financial statements submitted to you be approved.

Berne, 16 March 2006

BDO Visura

René-Marc Blaser	Karel Hojac
Auditor in Charge Swiss Certified Accountant	Swiss Certified Accountant

Enclosures
Consolidated financial statements
(income statement, balance sheet, statement of changes in shareholders' equity, cash flow statement and notes)

In thousands of CHF, except per share data

For the years ended December 31,	Notes	**2005**	**2004**
			Reclassified
Gross sales		**222'622**	**212'969**
Rebates and discounts		-2'955	-7'484
Net sales		**219'667**	**205'485**
Cost of sales		-140'439	-135'775
Gross profit		**79'228**	**69'710**
Marketing and sales		-32'644	-32'513
General and administrative expenses		-20'179	-20'517
Research and development		-12'442	-5'472
Operating income		**13'963**	**11'208**
Other non operating income / (expenses) - net		286	- 242
Earnings before interest and taxes (EBIT)		**14'249**	**10'966**
Financial expenses – net	8	-1'860	-3'300
Exchange gains – net		825	273
Income before income taxes		**13'214**	**7'939**
Income taxes	9	-379	-1'161
Net income		**12'835**	**6'778**
Earnings per share	21		
– basic		0.96	0.51
– diluted		0.93	0.51
Earnings before interest and taxes (EBIT)		**14'249**	**10'966**
Depreciation and amortisation		8'959	8'448
Profit before interest, income taxes, depreciation and amortisation (EBITDA)		**23'208**	**19'414**

The accompanying notes form an integral part of these consolidated financial statements.

CONSOLIDATED BALANCE SHEET

In thousands of CHF

As at December 31,	Notes	**2005**	**2004**
ASSETS			
Cash and cash equivalents		7’574	7’589
Trade receivables	10	41’653	39’549
Inventories	11	60’321	61’849
Other receivables and prepayments		7’896	9’276
Total current assets		**117’444**	**118’263**
Property, plant and equipment	12	48’366	54’010
Total non-current assets		**48’366**	**54’010**
Total assets		**165’810**	**172’273**
LIABILITIES AND SHAREHOLDERS’ EQUITY			
Interest bearing loans and borrowings	14	16’317	33’215
Trade payables		12’583	19’076
Other payables	15	21’661	16’940
Current tax liabilities		36	-
Provisions	16	6’412	10’749
Total current liabilities		**57’009**	**79’980**
Interest bearing loans and borrowings	14	2’050	2’398
Retirement benefit obligations	17	1’498	1’415
Provisions	16	3’996	3’917
Deferred tax liabilities	13	1’089	1’025
Total non-current liabilities		**8’633**	**8’755**
Total liabilities		**65’642**	**88’735**
Total shareholders’ equity		**100’168**	**83’538**
Total liabilities and shareholders’ equity		**165’810**	**172’273**

The accompanying notes form an integral part of these consolidated financial statements.

In thousands of CHF	**Ordinary shares**	**Share premium**	**Retained earnings/ (accumulated deficit)**	**Gain/(loss) on treasury shares**	**Currency translation difference**	**Total**
At December 31, 2003	**66'919**	**13'943**	**-1'855**	**–**	**-580**	**78'427**
Issuance of new shares	250	12				262
Net profit for the year			6'778			6'778
Gain / (loss) on treasury shares (note 18.3)				-11		-11
Currency translation difference					-1'918	-1'918
Recognised income / (expenses)			*6'778*	*-11*	*-1'918*	*4'849*
At December 31, 2004	**67'169**	**13'955**	**4'923**	**-11**	**-2'498**	**83'538**
Issuance of new shares	719	101				820
Net profit for the year			12'835			12'835
Gain / (loss) on treasury shares (note 18.3)				1'213		1'213
Currency translation difference					1'762	1'762
Recognised income			*12'835*	*1'213*	*1'762*	*15'810*
At December 31, 2005	**67'888**	**14'056**	**17'758**	**1'202**	**-736**	**100'168**

The accompanying notes form an integral part of these consolidated financial statements.

CONSOLIDATED CASH FLOW STATEMENT

In thousands of CHF

For the years ended December 31,	Notes	**2005**	**2004**
			Reclassified
Net income		**12'835**	**6'778**
Adjustments for:			
Taxes		379	1'161
Depreciation of property, plant and equipment	12	8'959	8'386
Loss on disposal of property, plant and equipment		3	297
Amortisation of other intangible assets		–	62
Other non cash items		-10	-215
Decrease / (increase) in working capital			
Trade receivables		-447	3'867
Other receivables		1'421	-2'133
Inventories		2'279	-6'627
Trade payables		-6'585	6'281
Other current payables and provisions		-209	3'251
Interest expenses		1'313	3'145
Income tax paid		-327	-1'177
Net cash provided by operating activities		**19'611**	**23'076**
Cash flow from investing activities			
Investment in property, plant and equipment		-2'486	-3'538
Disposal of property, plant and equipment		9	139
Disposal of financial assets		–	10
Interest received		95	129
Net cash used in investing activities		**-2'382**	**-3'260**
Cash flow from financing activities			
Repayments of borrowings, including finance lease liabilities		-33'097	-22'851
Proceeds from borrowings		15'417	1'258
Proceeds from issuance of share capital, net	18	820	262
Proceeds from sale of treasury shares	18.3	1'256	–
Payment of other financing expense	18.3	-43	–
Interest paid		-1'789	-3'119
Net cash used in financing activities		**-17'436**	**-24'450**
Decrease in cash and cash equivalents		-207	-4'634
Cash and cash equivalents at beginning of year		7'589	12'317
Effects of exchange rate changes		192	-94
Cash and cash equivalents at end of year		**7'574**	**7'589**

The accompanying notes form an integral part of these consolidated financial statements.

1 Activity and group structure

Tornos Holding S.A. (the Company) is a company domiciled in Moutier, Switzerland. The Group is exclusively active in developing, manufacturing, marketing and servicing of machine tools for turning applications. The Group's product lines primarily include sliding headstock lathes and multi-spindle lathes. The Group manufactures solely in Moutier, Switzerland and markets the product lines on a worldwide basis. The Group's operations outside of Switzerland principally include western European countries, North America and Asia.

These consolidated financial statements have been approved for issue by the Board of Directors on March 15, 2006. These financial statements will be submitted for approval to the General Meeting of Shareholders on April 11, 2006.

2 Summary of significant accounting policies

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These accounting policies have been consistently applied to all the years presented.

Certain amounts reported in prior years have been reclassified to conform with current year presentation.

The principal reclassifications relate to:
- Rebates previously deducted from Gross sales are classified as Rebates and discounts,
- Agent commissions previously deducted from Net sales are classified under Marketing and sales.

2.1 Basis of preparation

The consolidated financial statements have been prepared in accordance with the International Financial Reporting Standards (IFRS) and comply with Swiss law. The consolidated financial statements are prepared under the historical cost convention. All amounts set out in the consolidated financial statements are presented in Swiss francs (CHF), rounded to the nearest thousand (KCHF) unless otherwise stated.

The preparation of consolidated financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Company's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in note 4

2.2 Consolidation

Subsidiaries

Subsidiaries are those companies in which the Company, directly or indirectly, holds an interest of more than 50% of the voting rights or otherwise has power to exercise control over the operations. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. Acquisitions are accounted for using the purchase method. A listing of the Company's subsidiaries is set out in note 5.

Balances and transactions eliminated on consolidation

Intra-group balances and transactions, and any unrealised gains arising from intra-group transactions, are eliminated in preparing the consolidated financial statements.

2.3 Foreign currencies

Foreign currency transactions

Transactions in foreign currencies are translated to CHF at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to CHF at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities denominated in foreign currencies, which are stated at historical cost, are translated to CHF at the foreign exchange rate ruling at the date of the transaction.

Financial statements of foreign operations

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on consolidation, are translated to CHF at foreign exchange rates ruling at the balance sheet date. The revenues, expenses and cash flows of foreign operations are translated to CHF at the average exchange rates prevailing during the reporting period. Foreign exchange differences arising on this translation are recognised directly in equity as currency translation difference.

2.4 Revenue recognition

Revenues include sales of machines and service costs which can be directly charged to customers. Sales are recognised on the full completion of the delivery or service (upon delivery of products or customer acceptance in the case of "bill and hold" sales, or performance of services), net of sales taxes and discounts, and after eliminating sales within the Group.

2.5 Cash and cash equivalents

Cash and cash equivalents consist of cash balances and short-term liquid investments with original maturities of three months or less. They are stated at their nominal amounts.

2.6 Trade and other receivables

Trade and other receivables are stated at anticipated realisable value, being cost less allowances determined based on a review of all outstanding amounts at the year-end.

2.7 Inventories

Inventories are stated at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

The cost of inventories is based on the weighted average principle.

The cost of inventories includes expenditure incurred in acquiring the inventories and bringing them to their existing location and condition. In the case of manufactured inventories and work in progress, cost includes an appropriate share of overheads, except interest expenses, based on normal operating capacity.

2.8 Property, plant and equipment

Owned assets

Property, plant and equipment are stated at cost less accumulated depreciation (see below) and impairment losses, if any (see accounting policy 2.10). Interest cost on borrowings to finance property, plant and equipment during the course of construction are capitalised.

Subsequent expenditure

Expenditure incurred to replace a component of an item of property, plant and equipment that is accounted for separately, including major inspection and overhaul costs, is capitalised. Other subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the item of property, plant and equipment. All other expenditure is recognised in the income statement as an expense as incurred.

Leased assets

Leases with terms for which the Group assumes substantially all the risks and rewards of ownership are classified as finance leases. Plant and equipment acquired by way of finance leases are stated at an amount equal to the lower of their fair value and the present value of the minimum lease payments at inception of the leases, less accumulated depreciation (see below) and impairment losses, if any (see accounting policy 2.10).

Each lease payment is allocated between the liability and financial charges so as to achieve a constant rate on the finance balance outstanding. The corresponding lease obligations, net of financial charges, are included in interest bearing borrowings. The interest element of the finance charge is recognised in the income statement over the lease period.

Depreciation
Depreciation is charged to the income statement on a straight-line basis over the estimated useful lives of items of property, plant and equipment. Land is not depreciated. The estimated useful lives are as follows:

- Buildings 20-40 years
- Installations 8-12 years
- Machinery 8-12 years
- Other equipment 3-10 years

2.9 *Intangible assets*
Research and development
Internal research costs are charged against income as incurred. Internal development costs are capitalised as intangible assets only when there is an identifiable asset that will generate expected future economic benefits and when the cost of such an asset can be measured reliably. The Group does not currently have any such internal development costs that qualify for capitalisation as intangible assets. Development expenditure which does not meet the criteria above is recognised as an expense as incurred.

2.10 *Impairment*
The carrying amounts of the Group's assets, other than inventories (see accounting policy 2.7), deferred tax assets (see accounting policy 2.11) and pension assets (see accounting policy 2.12), are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount, being the higher of the asset's net selling price and value in use, is estimated. For intangible assets that are not yet available for use, the recoverable amount is estimated at each balance sheet date. An impairment loss is recognised whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in the income statement.

2.11 *Income taxes*
Income tax on the profit or loss for the year comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognised using the balance sheet liability method on temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

The amount of deferred tax recognised is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantially enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that sustainable future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

2.12 *Employee benefits*
The Group has established defined benefit and defined contribution plans around the world. Most of the pension schemes are final salary defined benefit plans and are either funded or unfunded. The assets of the funded plans are held independently of the Group's assets in separate trustee-administered funds.

Defined contribution plans
Contributions to defined contribution pension plans are recognised as an expense in the income statement as incurred.

Defined benefit plans
The Group's net obligation in respect of defined benefit pension and healthcare plans is calculated separately for each defined benefit plan by estimating the amount of future benefits that employees have earned in return for their service in the current and prior periods; such benefits are discounted to determine their present value, and the fair value of any plan assets is deducted from the defined benefit obligation. The discount rate is the yield at balance sheet date on AAA credit rated bonds that have maturity dates approximating the terms of the Group's obligations. The calculation is performed by a qualified actuary every year using the projected unit credit method.

When the benefits of a plan change, the portion of the increased benefits relating to past service by employees is recognised as an expense in the income statement on a straight-line basis over the average period until the benefits become vested. To the extent that the benefits vest immediately, the expense is recognised immediately in the income statement.

In calculating the Group's obligation in respect of a plan, to the extent that any actuarial gain or loss exceeds ten percent of the greater of the present value of the defined benefit obligation and the fair value of plan assets, it is recognised in the income statement over the expected average remaining working lives of the employees participating in the plan. Otherwise, the actuarial gain or loss is not recognised.

Where the calculation results in a surplus, the recognised asset is limited to the present value of any future refunds from the plan or reductions in future contributions to the plan.

2.13 Provisions
A provision is recognised in the balance sheet when the Group has a legal or constructive present obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

2.14 Interest bearing borrowings
Interest bearing borrowings are recognised initially at cost, less attributable transaction costs. Subsequent to initial recognition, interest bearing borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in the income statement over the period of the borrowings on an effective interest rate basis.

2.15 Segment reporting
The Group is engaged in the business of developing, manufacturing, marketing and servicing of machine tools for turning applications. The Group's products primarily include sliding headstock lathes and multi-spindle lathes. These products are mainly purchased by companies active in the electronic, automotive, connector, watch and medical engineering industries, as well as other specialised manufacturers of high precision turned parts.

The products of the Group require similar materials and production processes. Management does not consider that there is currently a clear distinction of risks and returns among the products and therefore concluded that the Group operates in one business segment, i.e. automatic lathes.

In view of the foregoing management has chosen the geographical segmentation for the purposes of the Group's primary segment reporting.

Switzerland is the domicile of the parent company and the main operating and distribution company. The Swiss operating company conducts all development and manufacturing activities. The subsidiaries located in the other western European countries (France, Germany, Italy, Spain and the United Kingdom), the United States and in Hong Kong only have support or sales and distribution activities. This organisation has the effect that the risks and returns of each geographical location are dependent to a large extent on the operating company in Switzerland. Management has identified four geographical segments, namely, Switzerland, other western European countries, North America and Asia. For the purpose of presenting net sales by location of customers, one other geographical segment, namely Rest of world, is identified.

2.16 Changes in accounting policies

In late 2003 the International Accounting Standards Board (IASB) published a revised version of IAS 32 'Financial Instruments: Disclosure and Presentation', a revised version of IAS 39 'Financial Instruments: Recognition and Measurement' and 'Improvements to International Accounting Standards', which makes changes to 14 existing standards. In the first quarter of 2004 the IASB published IFRS 2 'Share-based Payment', IFRS 3 'Business Combinations', IFRS 4 'Insurance Contracts', IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations', revised versions of IAS 36 'Impairment of Assets' and IAS 38 'Intangible Assets' and further amendments to IAS 39. In mid-2005 the IASB issued a further revision to IAS 39 regarding the Fair Value Option. The Group adopted these effective January 1, 2005 with the exception of IFRS 2 which it adopted in 2004. With the exception of IFRS 2, the adoption of the other new or revised standards was not deemed to have a material impact on the Group in 2004 or 2005.

2.17 New accounting standards and IFRIC interpretations

The Group is currently assessing the potential impacts of the new and revised standards that will be effective from January 1, 2006. Effective January 1, 2006 the Group will apply IAS 19 (revised) 'Employee Benefits'. Based on Management's current assessment, no change to the current accounting treatment for the recognition of actuarial gains and losses from defined benefit plans is foreseen. The Group does not expect that the other new and revised standards and interpretations will have a significant effect on the Group's results and financial position.

3 Financial risk management

3.1 Interest rate risks

The Group is exposed to changes in interest rates on borrowings bearing interest at floating rates. At December 31, 2005 and 2004 the Group did not hold any derivative financial instruments in order to limit the interest rate exposure of the Group.

3.2 Foreign currency risk

Tornos S.A., the Swiss operating company of the Group invoices its revenues to the subsidiaries and to customers located outside Switzerland in local currencies. Therefore the currency risk is transferred to the Swiss operating company. The Group decided not to follow any systematic hedging policy against currency risk through financial instruments but to adjust sales prices when exchange rates between CHF and other currencies fluctuate by more than 5%.

3.3 Credit risk

The Company and the Group have no significant concentration of credit risk.

3.4 Liquidity risk

Group treasury policy is to maintain flexibility in funding by keeping committed credit lines available.

3.5 Fair values

The carrying amounts of the following financial assets and financial liabilities approximate their fair values : cash, trade receivables, net of specific provisions for impairment and payables, other receivables and payables, loans, short-term borrowings and long-term borrowings predominantly negotiated at variable interest rates.

4 Critical accounting estimates and judgements

The preparation of financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. On an ongoing basis, management evaluate the estimates, including those related to provisions for warranty purpose and other provisions resulting from pending litigation and patent disputes as well as other present obligations of uncertain timing, inventory obsolescence, bad debts and the assessment of income taxes and retirement benefit obligations. Management bases the estimates on historical experience and on various other assumptions that it believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. Management believes the following critical accounting policies reflect the most significant judgments and estimates that are used in the preparation of the consolidated financial statements.

4.1 Bad debts

Allowances are made for estimated losses resulting from the inability of the customers to make required payments. If the financial condition of the customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances might be needed.

4.2 Inventory obsolescence

Machines, including work in progress machines on the assembly floors, are reviewed individually and recorded at the lower of cost and estimated net realisable value based upon assumptions about future demand and market conditions.

For raw material, component, semi-finished goods and spare parts the following inventory obsolescence and write-offs methodologies are applied for any slow moving or any otherwise obsolete inventory :

Raw material, components and semi-finished goods

For any article, the quantity of articles in stock cannot exceed 18 months of consumption based on the last 12 months of consumption. Any excess is fully provided for.

After 24 months without movement, the individual stock of articles is written-off. Once written-off, the articles are transferred to the Spare Parts department upon their request at NIL value.

After 48 months without movement, the stock is physically disposed of after second opinion from the Spare Parts department.

In case of a machine phase out all the related stocks of articles are fully written-off.

Spare parts in the spare parts department

For any article, the quantity of articles in stock cannot exceed 36 months of consumption based on the last 24 months of consumption. Any excess is fully provided for.

After 36 months without movement, the stock of articles is written-off.

After 72 months without movement, the stock is physically disposed of upon selective review.

If actual market conditions are less favorable than those projected, additional inventory write-downs may be needed.

4.3 Impairment of long-lived assets

Long-lived assets are regularly reviewed for impairment whenever events or changes in circumstances indicate that the balance sheet carrying amount of the asset may not be recoverable. In order to assess if there is any impairment, estimates are made of the future cash flows expected to result from the use of the asset and its eventual disposal. If the balance sheet carrying amount of the asset exceeds the higher of its value in use or its anticipated net selling price, an impairment loss for the difference is recognised. Future cash flows could vary from the estimates used in preparing the discounted cash flows. Factors such as changes in the planned use of buildings, machinery or equipment, or closing of facilities or lower than anticipated sales performance could result in shortened useful lives or impairment.

4.4 *Deferred taxes*

The Group had to take drastic restructuring measures in the recent past few years further to a history of severe down-turns and losses in its operating activities. Therefore, although profits before taxes of CHF 7.9 million and CHF 13.2 million were achieved for the twelve months ended December 31, 2004 and December 31, 2005 respectively, no deferred tax assets have been recognised as the Group has not yet demonstrated that it can sustain profitability at a sufficient level to ensure full or even partial recovery of the tax losses totaling CHF 224.5 million, a significant part of which matures in 2009 (note 13.2).

4.5 *Retirement benefit obligations*

The Group has established defined benefit and defined contribution plans around the world. Most of the pension schemes are final salary defined benefit plans and are either funded or unfunded. The assets of the funded plans are held independently of the Group's assets in separate trustee-administered funds. The expense incurred under the defined benefit retirement plans is based upon statistical and actuarial calculations, and is impacted by assumptions on discount rates used to determine the present value of future pension liabilities, expected returns that will be made on existing pension assets, future salary increases as well as future pension increases. Furthermore, the independent actuaries of the Group use statistical based assumptions covering future withdrawals of participants from the plan and estimates on life expectancy. The actuarial assumptions used may differ materially from actual results due to changes in market and economic conditions, higher or lower withdrawal rates or longer or shorter life spans of participants. These differences could impact significantly the amount of pension income or expense recognised in future periods.

4.6 *Warranty provision*

Warranty provision of CHF 7.1 million reflects management assessment of warranty claims. It is based on the level of sales as well as punctual quality issues which may be discovered. The total warranty provision takes into consideration all possible legally enforceable claims as well as actions undertaken for commercial reasons. Actual results may fluctuate significantly.

4.7 *Other provisions*

Other provisions amounting to CHF 3.3 million principally comprise the expected costs of pending litigation and patent disputes as well as other present obligations of uncertain timing, the outcome of which may prove to be more or less favorable than management currently believes.

4.8 *Contingencies*

Several of the Group subsidiaries are parties to various legal proceedings which are an ongoing feature of the business of the Group. As a result, claims could be made against them which might not be covered by existing provisions or by insurance. There can be no assurance that there will not be an increase in the scope of these matters or that any future lawsuits, claims, proceedings or investigations will not be material. Management does not believe that during the next few years, the aggregate impact, beyond current provisions, of these and other legal matters affecting the Group could be material to the Group's results of operations and cash flows, and to its financial condition and liquidity.

5 Scope of consolidation

Subsidiaries

Name	Domicile	Purpose
Tornos S.A., Moutier	Switzerland	Production and sales
Tornos Services S.A. en liquidation, Moutier	Switzerland	In liquidation
Tornos Technologies Deutschland GmbH, Pforzheim	Germany	Support services
Tornos Technologies Iberica SA, Granollers	Spain	Support services
Tornos Holding France, St-Pierre-en-Faucigny	France	Holding company
Tornos Technologies France SAS, St-Pierre-en-Faucigny	France	Support services
Tornos Technologies Italia Srl, Opera / MI	Italy	Support services
Tornos Technologies UK Ltd., Coalville	United Kingdom	Support services
Tornos Technologies U.S. Corp., Brookfield CT	United States	Sales & services
Tornos Technologies Asia Limited	Hong Kong	Sales & support services

At December 31, 2005 and 2004 Tornos Holding S.A. held 100% of the shares of Tornos S.A., Moutier, all the other Group companies being wholly-owned subsidiaries of Tornos S.A., Moutier.

Acquisitions and disposals

2005

Tornos Technologies Asia Limited, Hong Kong was founded on May 21, 2005 and is acting as a spare parts distributor and support services company in Asia. This is the only change in the scope of consolidation which occurred in the period under review.

2004

There were no acquisitions or disposals in the year 2004.

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

6 Expenses by nature

	2005	2004
Personnel expenses (note 7)	-75'706	-70'264
Changes in inventories of finished goods and work in progress, raw materials and consumables used	-85'534	-76'154
Depreciation and amortisation charges	-8'959	-8'448
Other expenses	-35'505	-39'411
Total cost of sales, marketing and sales, general and administrative expenses and research and development expenses	**-205'704**	**-194'277**

7 Personnel expenses

	2005	2004
Total personnel expenses	**-75'706**	**-70'264**
Of which:		
Defined benefit plans (note 17.2)	-3'522	-3'041
Defined contribution plans	-54	-43

8 Financial expenses - net

	2005	2004
Interest income from third party	96	129
Other financial income	2	8
Interest expenses to third parties	-1'409	-3'274
Bank charges and other financial expenses	-549	-163
Financial expenses - net	**-1'860**	**-3'300**

9 Income tax expense

	2005	2004
Current income tax expense	-315	-957
Deferred tax	-64	-204
Income tax expense	**-379**	**-1'161**

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

The Group's expected tax expense for each year is based on the weighted average of the statutory corporate income tax rates, which in 2005 ranged between 14 % and 42 %, in the tax jurisdictions in which the Group operates. The reconciliation of the expected and the effective income tax expense is as follows:

	2005	2004
Profit before tax	**13'214**	**7'939**
Expected tax expense	**-2'216**	**-2'128**
Weighted average applicable tax rate	16.8%	26.8%
Utilisation of previously unrecognised tax loss carryforwards	2'462	2'649
Reversal of write-down of deferred tax assets	200	621
Non-taxable income	3	318
Temporary differences on investments in subsidiaries	-542	-1'768
Write-down of deferred tax assets	-178	-320
Unrecognised tax loss carry forwards	–	-277
Expenses not deductible for tax purposes	-104	-201
Over / underfunded in previous years	–	-53
Other effects	-4	-2
Income tax expense recognised	**-379**	**-1'161**

The expected tax expense is calculated at entity level since the Group does not file consolidated tax returns. As such, profits and losses generated by different entities cannot be offset against each other. The decrease of the expected tax rate is due to an increased relative profitability of subsidiaries in environments with lower taxes.

10 Trade receivables

	2005	2004
Trade receivables	42'870	42'121
Less provision for impairment of receivables	-1'217	-2'572
Trade receivables, net	**41'653**	**39'549**

11 Inventories

	2005	2004
Materials and components	21'267	25'098
Work in progress	20'636	21'510
Finished goods and spare parts	31'915	37'230
Total inventories, gross	**73'818**	**83'838**
Less allowance for obsolescence	-13'497	-21'989
Total inventories, net	**60'321**	**61'849**

The decrease in the allowance for obsolescence is mainly a result of articles being discarded for which a 100% allowance had previously been established.

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

12 Property, plant and equipment

	Land buildings & installations	Machinery	Other equipment	Total
	Reclassified	Reclassified	Reclassified	
Cost				
At December 31, 2003	**64'595**	**68'123**	**9'487**	**142'205**
Additions	1'847	302	1'498	3'647
Disposals	-318	-1'181	-1'555	-3'054
Translation adjustment	-353	-56	-102	-511
At December 31, 2004	**65'771**	**67'188**	**9'328**	**142'287**
Additions	447	253	2'167	2'867
Disposals	-647	-348	-3'105	-4'100
Transfers between categories	-241	–	241	–
Translation adjustment	581	91	167	839
At December 31, 2005	**65'911**	**67'184**	**8'798**	**141'893**
Accumulated depreciation				
At December 31, 2003	**-25'793**	**-48'876**	**-8'063**	**-82'732**
Charge for the year	-2'517	-5'123	-746	-8'386
Written back on disposal	194	1'040	1'384	2'618
Translation adjustment	101	46	76	223
At December 31, 2004	**-28'015**	**-52'913**	**-7'349**	**-88'277**
Charge for the year	-2'579	-5'104	-1'276	-8'959
Written back on disposal	647	345	3'096	4'088
Transfers between categories	54	–	-54	–
Translation adjustment	-169	-82	-128	-379
At December 31, 2005	**-30'062**	**-57'754**	**-5'711**	**-93'527**
Carrying amounts				
December 31, 2004	**37'756**	**14'275**	**1'979**	**54'010**
December 31, 2005	**35'849**	**9'430**	**3'087**	**48'366**

Of which related to leased assets:

	Land buildings & installations	Machinery	Other equipment	Total
Additions				
December 31, 2004	–	–	109	109
December 31, 2005	–	–	381	381
Carrying amounts				
December 31, 2004	1'176	10'228	198	11'602
December 31, 2005	1'052	3'313	379	4'744

The fire insurance value of PP&E and inventories amounts to CHF 367 million (prior year : CHF 365 million).

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

13 Deferred taxes

13.1 Deferred tax assets and liabilities

Deferred tax assets and liabilities are attributable to the following:

	2005		2004	
	Assets	**Liabilities**	**Assets**	**Liabilities**
Trade and other receivables	–	8	47	4
Property, plant and equipment	135	1’129	–	1’164
Investments in subsidiaries	–	438	–	348
Trade and other payables	–	82	–	89
Retirement benefit obligations	14	80	1	–
Provisions	9	–	21	–
Borrowings	490	–	511	–
Tax assets / liabilities	**648**	**1’737**	**580**	**1’605**
Set off	-648	-648	-580	-580
Net tax assets / liabilities	**–**	**1’089**	**–**	**1’025**

A deferred tax liability related to unrecoverable withholding taxes on retained earnings of subsidiaries has been recognised.

Deferred tax assets and deferred tax liabilities were set off where there is a legally enforceable right to set off these taxes as they relate to the same tax authorities.

There are no deferred taxes which have been recognised directly in equity.

13.2 Unrecognised deferred tax assets

Deferred tax assets have not been recognised in respect of the following items:

	2005	**2004**
Deductible temporary differences	4’256	3’672
Tax losses carried forward	224’550	241’783
Total	**228’806**	**245’455**

The Group had to take drastic restructuring measures in the recent past few years further to a history of severe down-turns and losses in its operating activities. For this reason and although the years 2004 and 2005 result in a profit, no deferred tax assets are recognised until the Group has proven it can operate with sustainable profits in the next few years.

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

The expiry dates of unrecognised tax loss carry forwards are as follows:

	2005	**2004**
Year 2006	–	1'243
Year 2007	–	–
Year 2008	4'591	18'872
Year 2009	209'686	210'756
After 2009	6'969	6'966
Losses not subject to expiry	3'304	3'946
Total	**224'550**	**241'783**

The deductible temporary differences for which no deferred tax asset has been recognised do not expire.

13.3 Tax rulings

On July 5, 2000, tax rulings were obtained from the tax authorities of the Canton of Berne and the local authorities of Moutier whereby tax holidays were granted to the Swiss operating companies.

Tornos S.A. was 100% tax exempted for the years 2000 to 2001, 80% tax exempted from 2002 to 2003 and is 60% tax exempted from 2004 to 2006.

14 Interest bearing loans and borrowings

	2005	**2004**
Current portion:		
Current portion of credit facility	15'000	30'000
Mortgage	77	74
Other short-term bank borrowings	731	314
Short-term leasing liabilities (note 14.6)	509	2'827
Current portion	**16'317**	**33'215**
Non-current portion:		
Long-term leasing liabilities (note 14.6)	1'222	1'528
Mortgage	828	870
Non-current portion	**2'050**	**2'398**
Total interest bearing loans and borrowings	**18'367**	**35'613**

14.1 Credit agreement with banks

Most interest bearing loans and borrowings are made to the Swiss operating company. Mortgage is granted to a subsidiary at a floating rate of 6.625 % at December 31, 2005 (5.875% at December 31, 2004).

On April 25, 2005 the Group concluded a new Credit Facility Agreement with a new syndicate of banks. Under this agreement the syndicate of banks grants to Tornos S.A. as borrower with Tornos Holding S.A. acting as guarantor a credit facility in the aggregate of CHF 42.5 million. Of this amount, CHF 30 million can be used for advances of up to 12 months and CHF 12.5 million for current overdrafts and the issuance of bank guarantees of up to 12 months. This Credit Facility Agreement which is valid until December 31, 2007 is subject to certain conditions and financial covenants related to total debt to EBITDA and interest cover ratios as well as tangible net worth.

The interest charged on the advances is based on the LIBOR rate plus an applicable margin. The applicable margin ranges between 1.30% and 3.10% per annum and is based on the total debt to EBITDA ratio. This Credit

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Facility Agreement is also subject to a commitment fee on the average undrawn and uncancelled amount of the Facility until the end of the availability.

14.2 *Facilities*

Below is a summary of the credit facilities granted by the creditor banks:

	Term loan credit facility CHF million	**Working capital facilities** CHF million	**Total** CHF million
Former consortium of banks			
At December 31, 2004			
Available	41.0	11.0	52.0
Used	30.0	4.3	34.3
Interest rate	LIBOR + 4.25%		
New syndicate of banks			
At December 31, 2005			
Available	30.0	12.5	42.5
Used	15.0	4.5	19.5
Interest rate	LIBOR + 1.80%		

The term loan credit facility can be used for roll over periods up to 12 months. The amount used at December 31, 2005 matures on January 12 and January 23, 2006 and bears interest at 2.70% and 2.76%.

The working capital facility may be used in the form of overdraft on current accounts, letters of credit, performance, bid and advance payment bonds, foreign exchange transactions or guarantees.

14.3 *Maturity schedule*

	2005	**2004**
Within 1 year	16’317	33’215
Between 1 and 2 years	415	509
Between 2 and 5 years	713	812
Over 5 years	922	1’077
Total borrowings	**18’367**	**35’613**

14.4 *Interest rate exposure*

	2005	**2004**
At fixed rates	436	34’355
At floating rates	17’931	1’258
Total borrowings	**18’367**	**35’613**

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

14.5 Exchange rate exposure

The original currencies of the Group's borrowings are:

	2005	2004
Swiss franc	17'527	33'050
Euro	-252	1'492
British Pound	1'154	1'044
US Dollar	-62	27
Total borrowings	**18'367**	**35'613**

To be consistent with the legal right of offset that each bank has over all bank accounts maintained by each company of the Group, the net position of all bank current accounts with each bank is the basis for classification as either Cash and cash equivalent or Borrowings

14.6 Finance lease liabilities

	2005	2004
Minimum lease payments		
Within 1 year	593	3'164
Between 2 to 5 years	915	1'202
More than 5 years	477	569
Total minimum lease payments	**1'985**	**4'935**
Future finance charges on finance leases	-254	-580
Present value of finance lease liabilities	**1'731**	**4'355**
Of which		
Due within 1 year	509	2'827
Between 2 to 5 years	775	972
More than 5 years	447	556

The majority of the finance lease liabilities of the Group carry an effective interest rate of 3.432% at December 31, 2005 (2004: 4.8%).

15 Other payables

	2005	2004
Advances received	9'182	3'864
Payable to pension plans	479	431
Other payables and accrued expenses	12'000	12'645
Total other payables	**21'661**	**16'940**

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

16 Provisions

	Warranties	Restruc-turing	Other	Total
At beginning of year	**9'580**	**576**	**4'510**	**14'666**
Additional provisions	4'833	–	648	5'481
Utilised during the year	-7'397	-195	-715	-8'307
Released via income statement	-14	-358	-1'110	-1'482
Exchange differences	50	–	–	50
At end of year	**7'052**	**23**	**3'333**	**10'408**

	2005	2004
Current liabilities	6'412	10'749
Non-current liabilities	3'996	3'917
Total	**10'408**	**14'666**

Warranties
The Company gives a contractual one-year warranty on machines sold and undertakes to repair or replace items that fail to perform satisfactorily. The Group also recognises a provision to upgrade existing machines.

Restructuring
A provision of CHF 0.3 million was made as of December 31, 2004 for employees who were laid off during 2002 restructuring. This provision was reversed in 2005 as it could not be used for that purpose due to practical reasons related to Swiss legislation on social welfare.

Other Provisions
Other provisions include the expected costs of pending litigation and patent disputes as well as other present obligations of uncertain timing. Management reassessed the provision for other risks and provisions of CHF 1.1 million were released through the income statement during the year under review as the outcome of various present obligations foreseen at the end of the prior year was finally more favorable than management believed.

17 Retirement benefit obligations

17.1 Description of pension schemes

Substantially all employees are eligible for retirement benefits. Among the benefit schemes are defined benefit plans as well as defined contribution plans. The locations with significant defined benefit plans are Switzerland, USA, France, Germany and Italy.

Retirement benefits are provided based on a final or average pay and service formula. Some of the plans provide only lump sum benefits in the events of leaving the Group and retirement. The last actuarial valuation was performed as of December 31, 2005 using the projected unit credit method.

The following summarises the components of pension cost, the funded status, the resulting prepaid assets or accrued liabilities and the underlying actuarial assumptions.

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

17.2 Net period pension cost recognised in personnel expenses

	Switzerland		Outside Switzerland		Total	
	2005	2004	2005	2004	2005	2004
Current service cost	6'153	6'041	240	216	6'393	6'257
Interest cost	4'102	4'644	159	169	4'261	4'813
Expected return on assets	-4'980	-5'530	-109	-117	-5'089	-5'647
Amortisation of						
unrecognised past service cost	-176	-46	-6	-6	-182	-52
unrecognised net loss	80	47	8	3	88	50
Remeasurement of asset ceiling	1'108	369	–	–	1'108	369
Curtailment / settlement	–	–	–	–	–	–
Employees' contributions	-3'057	-2'749	–	–	-3'057	-2'749
Net periodic pension cost recognised	**3'230**	**2'776**	**292**	**265**	**3'522**	**3'041**

17.3 Actual return on plan assets

	Switzerland		Outside Switzerland		Total	
	2005	2004	2005	2004	2005	2004
Actual return	3'851	3'025	72	-209	3'923	2'816

17.4 Amounts recognised in the balance sheet

	Switzerland		Outside Switzerland		Total	
	2005	2004	2005	2004	2005	2004
Present value of funded obligations	131'840	130'927	3'318	2'361	135'158	133'288
Fair value of assets	-125'967	-126'863	-1'911	-1'636	-127'878	-128'499
Under funding	**5'873**	**4'064**	**1'407**	**725**	**7'280**	**4'789**
Present value of unfunded obligations	568	832	360	463	928	1'295
Unrecognised past service cost	2'798	872	19	25	2'817	897
Unrecognised net loss	-8'862	-5'340	-665	-226	-9'527	-5'566
Net accrued pension cost recognised	**377**	**428**	**1'121**	**987**	**1'498**	**1'415**

The assets of the funded plans are held independently of the Group's assets in separate trustee administered funds. They include marketable securities, real estate and other assets. No shares issued by the Group are included in the assets of the funded plans at December 31, 2005 and 2004. In Switzerland, the Pension Fund is controlled by an equal number of representatives of management and the employees. This parity of control implies that neither side individually controls the funds paid into the pension fund. Therefore, the Company cannot dictate on its own that any excess funds will be used for the benefit of the Company (i.e. to reduce future contributions).

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

17.5 *The movements in net accrued pension costs are as follows:*

	2005	2004
At beginning of year	1'415	1'624
Net periodic pension costs (note 17.2)	3'522	3'041
Employer contributions	-3'516	-3'207
Exchange differences	77	-43
At end of year	**1'498**	**1'415**

17.6 *Weighted average assumptions*

The following are the major assumptions used in the actuarial calculations:

	Switzerland		Outside Switzerland	
	2005	2004	2005	2004
Discount rate	2.75	3.25	5.25	5.49
Expected return on plan assets	4.00	4.50	6.31	6.13
Salary increases	1.93	1.94	3.18	3.84
Pension indexation	0.10	0.50	0.21	1.33

18 Share capital

18.1 *Capital structure*

	Issued registered shares	Treasury shares	Total shares in circulation
Issued and fully paid-in at December 31, 2003	**13'383'755**	**168'110**	**13'215'645**
Issued for cash	50'000		50'000
Issued and fully paid-in at December 31, 2004	**13'433'755**	**168'110**	**13'265'645**
Issued for cash	143'750		143'750
Sold		-118'110	118'110
Issued and fully paid-in at December 31, 2005	**13'577'505**	**50'000**	**13'527'505**

2005

During the year 2005:

- 50'000 registered shares were issued and fully paid for at a price of CHF 5.30 each during the 1st semester of 2005 under the 2004 Management and Board Participation Plan
- 93'750 registered shares were issued and fully paid for at a price of CHF 6.00 in December 2005 further to the exercise of options granted to a former creditor bank as compensation for its debt waiver in 2002.

As a result of the above issues of shares the following changes were made to the Articles of incorporation of the Company during 2005:

- The share capital amounts to CHF 67'887'525 represented by 13'577'505 registered shares of CHF 5.00 each.
- The conditional share capital was reduced to CHF 7.3 million which can be used for the issue of registered shares of CHF 5.00 each to be fully paid to be allocated as follows :
  - for a maximum amount of CHF 5.5 million which is reserved for the issuance of shares upon the exercise of option rights which were granted to certain creditor banks in consideration of them waiving part of their claims in 2002 which can be exercised until July 2007

- for a maximum amount of CHF 1.8 million which is reserved for the issuance of shares that may be used by the Board of Directors to satisfy stock purchase and option plans in favor of eligible members defined by the Board of Directors.

2004

Subsequent to the General Meeting of Shareholders held on April 13, 2004 the following share capital changes were adopted **(bold mark)**:

- Increase the conditional capital of the company to **CHF 14 million** by the issue of registered shares of CHF 5.00 each to be fully paid to be allocated as follows :
  - for a maximum amount of CHF 5.75 million which is reserved for the issuance of shares upon the exercise of option rights which were granted to the shareholders within the framework of the reduction of the share capital in 2002 which can be exercised until September 2004
  - for a maximum amount of CHF 6.0 million which is reserved for the issuance of shares upon the exercise of option rights which were granted to certain creditor banks in consideration of them waiving part of their claims in 2002 which can be exercised until July 2007
  - **for a maximum amount of CHF 2.25 million which is reserved for option rights granted to eligible members defined by the Board of Directors.**

During the year 2004:

- 50'000 registered shares were issued and fully paid for at a price of CHF 5.30 each during the 1st semester of 2004 under the 2004 Management and Board Participation Plan
- option rights for a total share capital amount of CHF 5.75 million granted to shareholders further to the 2002 capital restructuring matured in September 2004 and were not exercised
- the part of the authorised share capital in the amount of CHF 4.58 million which was resolved at the June 28, 2002 shareholders' meeting having not been used during the two years prescribed by law was cancelled. As a result there is no more authorised capital.

18.2 Shares outstanding and rights attached to each class of shares

As of December 31, 2005 the share capital consisted of 13'577'505 ordinary registered shares with a par value of CHF 5.00 each. The holders of the ordinary shares are entitled to receive dividends as declared by the meeting of shareholders and are entitled to one vote per share at the meetings of shareholders.

18.3 Treasury shares

In connection with the Group's financial restructuring in 2002, Tornos Holding S.A. entered into agreements with its suppliers, under which it received 168'110 of its own shares from one of its suppliers in August 2003. The Company paid CHF 0 compensation for these shares and they have been recorded pro memoria in the balance sheet. 118'110 of these treasury shares were sold during 2005 for KCHF 1'256.

As from July 12, 2004, 50'000 of these shares were loaned to a third party for market making purpose. The Group is charged a fixed fee for each share movement, any gains and losses resulting from the shares sold / bought being at the profit / expense of the third party. During the year 2005, total costs incurred totaled KCHF 43 (2004: KCHF 11).

18.4 Conditional share capital

The conditional share capital amounts to CHF 7.3 million. An amount of CHF 5.5 million is reserved for the issuance of shares upon exercise of option rights which were granted to certain creditor banks and creditors in consideration of them waiving part of their claims further to the restructuring in 2002. An amount of CHF 1.8 million is reserved for the issuance of shares that may be used by the Board of Directors to satisfy stock purchase and option plans in favor of eligible members defined by the Board of Directors.

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

18.5 *Significant shareholders*

The following shareholders or groups of shareholders held more than 5 percent of the share capital of the Company at December 31, 2005 and 2004:

	2005	2004
Management Group	10.3%	–
Günther and Helmut Rothenberger	6.7%	6.5%
Alpine Select AG	5.4%	–
Doughty Hanson Group	–	27.4%
Credit Suisse Group	–	24.7%

19 Stock options

In 2002, the Group granted options to the shareholders in the framework of the reduction of the share capital and to the creditor banks as compensation for their debt waiver and for granting a bridge loan. Additional options were granted to the former shareholders in connection with the settlement of a legal dispute in 2002. 93'750 of these options were exercised until December 31, 2005.

At December 31, 2005, the following options were still outstanding in this respect:

	Number of options	Expiry date
Options granted to creditor banks for waiver of loans	656'250	08.07.2007
Options granted to creditor banks for bridge loan	300'000	16.07.2007
Options granted to former shareholders	125'000	08.07.2007

Each of the options granted to the creditor banks and to the former shareholders entitles the holder to purchase one registered share for a price of CHF 6.00.

The options are secured by the conditional share capital of CHF 7.3 million (note 18.4)

20 Stock compensation plans

The General Meeting of Shareholders held on April 13, 2004 approved the issue of 450'000 conditional shares that may be used by the Board of Directors to satisfy stock purchase and option plan commitments set out below.

Share Purchase Plan

Under the 2004 Management and Board Participation Plan, eligible members selected by the Board of Directors were offered 150'000 registered shares at CHF 5.30 per share to be issued in three equal tranches over a three-year period. The purchase price was deemed equivalent to the fair market value at the date each eligible member contractually committed to purchasing the shares, hence no compensation expense has been calculated in respect of the above. As at December 31, 2005, 100'000 registered shares had been issued under the 2004 Management and Board Participation Plan. Subscriptions for 43'329 registered shares to be issued on May 1, 2006 had been received as at December 31, 2005. The 6'671 remaining shares available under this plan will be offered to the participants on May 1, 2006.

Stock Option Plan

Under the 2004 Management and Board Participation Plan, eligible members selected by the Board of Directors were issued options to purchase registered shares at a strike price of CHF 6.00 per share. The terms and conditions with respect to options granted were determined by the Board of Directors who administered these plans. Options vest over two years and remain outstanding for periods not exceeding three years. A total of 300'000 registered shares may be issued under this plan.

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

Compensation expense is recognised over the vesting period in accordance of the provisions of IFRS 2 “Share-based Payment”. Compensation expense of KCHF 136 was recorded for the year ended December 31, 2005 (December 31, 2004: KCHF 25). Such amounts are accrued as a liability when the expense is recognised and subsequently credited to additional paid-in capital upon exercise of the related stock options. Compensation expense arising from stock options outstanding at December 31, 2005 to be recognised in future periods amounts to KCHF 209 (December 31, 2004: KCHF 50).

A summary of activity under the stock option plans, including weighted average exercise price, is as follows:

	Options	**Exercise price** (CHF)	**Contractual live**
Outstanding at December 31, 2003	**–**	**–**	
Granted	100’000	6.00	3 years (April 30, 2007)
Exercised	–	–	
Cancelled or expired	–	–	
Outstanding at December 31, 2004	**100’000**	**6.00**	
Exercisable at December 31, 2004	**–**	**–**	
Granted	100’000	6.00	3 years (April 30, 2008)
Exercised	–	–	
Cancelled or expired	–	–	
Outstanding at December 31, 2005	**200’000**	**6.00**	
Exercisable at December 31, 2005	**–**	**–**	

Considering the immateriality of the stock option plan, the fair value of the grants was estimated using the Black-Scholes valuation model with the following assumptions and values:

	Options granted in 2005	Options granted in 2004
Options granted	100’000	100’000
Dividend yield	–	–
Expected life	2.5 years	2.5 years
Expected volatility	25%	25%
Risk free interest rate	1.03%	1.60%
Fair value of grants per option	CHF 2.95	CHF 0.75
Expected turnover of personnel	–	–

The expected volatility used to calculate the fair value differs from the historical volatility of the Company’s share price. Management considers that the historical volatility is not a reasonable basis upon which to estimate future volatility given the impact that the restructuring measures undertaken in 2002 had on both the share price and the trading volumes experienced during 2003 and 2004.

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

21 Earnings per share, basic and fully diluted

21.1 Basic

Basic earnings per share is calculated by dividing the profit attributable to equity holders of the Company by the weighted average number of ordinary shares in issue during the year, excluding ordinary shares purchased by the Company and held as treasury shares (note 18.3).

	2005	2004
Profit attributable to equity holders of the Company	12'835	6'778
Weighted average number of ordinary shares in issue (thousands)	13'368	13'249
Basic earnings per share (CHF per share)	**0.96**	**0.51**

21.2 Diluted

Diluted earnings per share is calculated by adjusting the weighted average number of ordinary shares outstanding to assume conversion of all dilutive potential ordinary shares. The Company has one category of dilutive potential ordinary shares: share options. For the share options, a calculation is done to determine the number of shares that could have been acquired at fair value (determined as the average annual market share price of the Company's shares) based on the monetary value of the subscription rights attached to outstanding share options. The number of shares calculated as above is compared with the number of shares that would have been issued assuming the exercise of the share options.

	2005	2004
Profit attributable to equity holders of the Company	12'835	6'778
Weighted average number of ordinary shares in issue (thousands)	13'368	13'249
Adjustments for share options (thousands)	501	–
Weighted average number of ordinary shares for diluted earnings per share (thousands)	13'869	13'249
Diluted earnings per share (CHF per share)	**0.93**	**0.51**

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

22 Segment information

As described in note 2.15 above, management of the Group has chosen geographical segments for the purpose of primary segment reporting in accordance with IAS 14. The reportable segments identified are Switzerland, Other western European countries, North America and Asia. For the purpose of presenting net sales by location of customers, one other geographical segment, namely Rest of world, is identified.

22.1 Net sales by location of assets

	2005	2004
Switzerland:		
– To third parties	184'244	122'425
– To other segments	18'745	53'457
	202'989	**175'882**
Other western European countries:		
– To third parties	4'149	43'628
– To other segments	792	3'079
	4'941	**46'707**
North America:		
– To third parties	31'252	39'431
– To other segments	–	24
	31'252	**39'455**
Asia:		
- To third parties	22	–
- To other segments	–	–
	22	**–**
Elimination	-19'537	-56'559
Total net sales	**219'667**	**205'485**

22.2 Net sales by location of customers

	2005	2004
Switzerland	51'334	24'120
Other western European countries	118'177	129'956
North America	33'149	39'432
Asia	13'862	6'915
Rest of world	3'145	5'062
Total net sales	**219'667**	**205'485**

22.3 Segment result (EBIT) by location of assets

	2005	2004
Switzerland	12'381	8'548
Other western European countries	1'995	-536
North America	146	1'715
Asia	-39	–
Total	**14'483**	**9'727**
Elimination	-99	118
Unallocated	-135	1'121
Total EBIT	**14'249**	**10'966**

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

The transactions between Group companies are conducted based on internationally acceptable transfer pricing policies, thereby leaving reasonable margins at local subsidiary level.

22.4 *Segment assets*

	2005	2004
Switzerland	155'372	165'849
Other western European countries	16'196	24'530
North America	16'917	20'729
Asia	215	–
Total	**188'700**	**211'108**
Elimination	-22'890	-38'835
Total assets	**165'810**	**172'273**

22.5 *Segment liabilities*

	2005	2004
Switzerland	47'093	55'679
Other western European countries	16'704	24'846
North America	4'158	9'712
Asia	249	–
Total	**68'204**	**90'237**
Elimination	-22'054	-38'140
Unallocated liabilities:		
– Tax liabilities	1'125	1'025
– Interest bearing borrowings	18'367	35'613
Total liabilities	**65'642**	**88'735**

22.6 *Depreciation of property, plant and equipment by segment*

	2005	2004
Switzerland	-8'068	-7'712
Other western European countries	-706	-516
North America	-178	-158
Asia	-7	–
Total depreciation	**-8'959**	**-8'386**

22.7 *Amortisation of goodwill and other intangible assets by segment*

	2005	2004
Switzerland	–	-9
Other western European countries	–	-53
North America	–	–
Asia	–	–
Total amortisation	**–**	**-62**

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

22.8 Capital expenditure on property, plant and equipment and other intangible assets by segment

	2005	2004
Switzerland	1'848	1'688
Other western European countries	745	1'786
North America	228	173
Asia	46	–
Total capital expenditure	**2'867**	**3'647**

23 Commitments and contingencies

23.1 Operating lease commitments

Operating lease liabilities, minimum lease payments

	2005	2004
Year 1	1'065	1'201
Years 2 to 5	1'121	1'162
After 5 years	71	70
Total minimum lease payments	**2'257**	**2'433**

23.2 Other commitments and contingent liabilities

As of December 31, 2005 there were no other commitments or contingent liabilities not in the ordinary course of business.

23.3 Contingent sale

For operational reasons the Group envisages to sell a building which is outside the boundaries of its site and in such an event to build a new facility within the limits of the site. However, for the time being no final agreements have been reached.

23.4 Assets pledged

At December 31, 2005 and 2004, the following assets were pledged to creditor banks or leasing companies:

	2005	2004
Trade receivables	–	39'549
Land and buildings	1'403	33'893
Technical machinery & other equipment	3'692	10'426
Total assets pledged	**5'095**	**83'868**

At December 31, 2005, the total value of the pledged mortgage notes related to land and buildings amount to CHF 1 million (CHF 41 million at December 31, 2004).

At December 31, 2005, further to the new Credit Facility Agreement signed on April 25, 2005 with the new syndicate of banks (note 14.1), the Company and each Director holding shares in Tornos S.A., Moutier pledged all shares in the latter, free of any security interest or any other encumbrance in favour of the new syndicate of banks as security for the due and punctual fulfillment of the obligations of both Tornos S.A., Moutier, as the borrower, and Tornos Holding S.A., Moutier as the Parent.

24 Related party transactions

Credit Suisse and Doughty Hanson & Co, the two main shareholders of Tornos Holding S.A. with 24.7% and 27.4% respectively in the capital of the Company at December 31, 2004, supported the recapitalisation of the Group which took place in 2002. As these shareholders always intended to divest at the end of the restructuring process which is now complete, all shares held by these two establishments were placed with institutional investors and a group of shareholders formed by members of the Board of Directors and the management team of Tornos.

Remuneration, consisting of fees, to non-executive members of the Board of Directors amounted to CHF 0.4 million in 2005 (CHF 0.4 million in 2004). Remuneration, consisting principally of salaries and bonuses, to the executive member of the Board of Directors and the members of Group management totaled CHF 2.2 million in 2005 (CHF 1.7 million in 2004). As of December 31, 2005, the Board of Directors and Group management held 1’450’194 shares (10.7%) of the Company and 200’000 option rights (note 20). Of the 1’450’194 shares, 1’392’240 shares (10.3%) are owned by a group of shareholders which has signed a shareholders’ agreement. For further information refer to the “Corporate Governance” section of the annual report.

Credit Suisse, a significant shareholder of the Company until May 24, 2005 was the lead bank of a consortium of banks that granted credit facilities (loans, advances and guarantees) until April 30, 2005. On April 25, 2005 the Group concluded a new Credit Facility Agreement with a new syndicate of banks. The financial expenses related to facilities granted by the former consortium of banks amounted to CHF 0.6 million until the end of May 2005 (CHF 2.5 million for the year 2004).

25 Post balance sheet events

There are no post balance sheet events.

Report of the statutory auditors
to the general meeting of

Tornos Holding S.A., Moutier

As statutory auditors, we have audited the accounting records and the financial statements (income statement, balance sheet, statement of changes in shareholders' equity and notes) of Tornos Holding S.A. for the year ended 31 December 2005.

These financial statements are the responsibility of the Board of Directors. Our responsibility is to express an opinion on these financial statements based on our audit. We confirm that we meet the legal requirements concerning professional qualification and independence.

Our audit was conducted in accordance with Swiss Auditing Standards, which require that an audit be planned and performed to obtain reasonable assurance about whether the financial statements are free from material misstatement. We have examined on a test basis evidence supporting the amounts and disclosures in the financial statements. We have also assessed the accounting principles used, significant estimates made and the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the accounting records, the financial statements and the proposed appropriation of available earnings comply with Swiss law and the company's articles of incorporation.

We recommend that the financial statements submitted to you be approved.

Berne, 16 March 2006

BDO Visura

René-Marc Blaser	Karel Hojac
Auditor in Charge	
Swiss Certified Accountant	Swiss Certified Accountant

Enclosures

- Financial statements
  (income statement, balance sheet, statement of changes in shareholders' equity and notes)
- Proposed appropriation of available earnings

In thousands of CHF

For the years ended December 31,	Notes	**2005**	**2004**
Interest income from a subsidiary		**720**	**520**
Board of Directors and management remuneration		-508	-363
Audit, legal and consulting fees		-568	-141
Other expenses	3.2	-43	-11
Taxes other than on income		-19	-3
Total operating expenses		**-1'138**	**-518**
Total operating income / (loss)		**-418**	**2**
Gain on sales of treasury shares	3.2	1'256	–
Financial expenses		-4	-2
Net income for the year		**834**	**–**

The accompanying notes form an integral part of these financial statements.

BALANCE SHEET

In thousands of CHF

As at December 31,	Notes	**2005**	**2004**
ASSETS			
Cash and cash equivalents		7	54
Group receivables		585	656
Other receivables		–	1
Prepaid expenses		–	29
Total current assets		**592**	**740**
Investment in a subsidiary	2	65'000	65'000
Loan to a subsidiary		18'000	16'000
Total non-current assets		**83'000**	**81'000**
Total assets		**83'592**	**81'740**
LIABILITIES AND SHAREHOLDERS' EQUITY			
Accrued liabilities		285	87
Total current liabilities		**285**	**87**
Ordinary shares	3	67'888	67'169
Additional paid-in capital		14'056	13'955
Retained earnings		1'363	529
Total shareholders equity		**83'307**	**81'653**
Total liabilities and shareholders' equity		**83'592**	**81'740**

The accompanying notes form an integral part of these financial statements.

In thousands of CHF	**Ordinary shares**	**Additional paid-in capital**	**Retained earnings**	**Total**
At December 31, 2003	**66'919**	**13'943**	**529**	**81'391**
Issuance of new shares (note 3)	250	12		262
Net income for the year			–	–
At December 31, 2004	**67'169**	**13'955**	**529**	**81'653**
Issuance of new shares (note 3)	719	101		820
Net profit for the year			834	834
At December 31, 2005	**67'888**	**14'056**	**1'363**	**83'307**

The accompanying notes form an integral part of these financial statements.

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

1 Basis of preparation

The financial statements of Tornos Holding S.A., Moutier (the Company) as of December 31, 2005 have been prepared in accordance with the provisions of the Swiss law and the Company's Articles of Incorporation.

2 Subsidiary

The only subsidiary of the Company is Tornos S.A., Moutier. It is a wholly-owned production and sales entity at December 31, 2005 and 2004 with a share capital of CHF 65 million.

3 Share capital

During the year 2005:

- 50'000 registered shares were issued and fully paid for at a price of CHF 5.30 each during the 1st semester of 2005 under the 2004 Management and Board Participation Plan
- 93'750 registered shares were issued and fully paid for at a price of CHF 6.00 in December 2005 further to the exercise of options granted to a former creditor bank as compensation for its debt waiver in 2002.

As a result of the above issues of shares the following changes were made to the Articles of incorporation of the Company during 2005:

- The share capital amounts to CHF 67'887'525 represented by 13'577'505 registered shares of CHF 5.00 each.
- The conditional share capital was reduced to CHF 7.3 million which can be used for the issue of registered shares of CHF 5.00 each to be fully paid to be allocated as follows :
  - for a maximum amount of CHF 5.5 million which is reserved for the issuance of shares upon the exercise of option rights which were granted to certain creditor banks in consideration of them waiving part of their claims in 2002 which can be exercised until July 2007
  - for a maximum amount of CHF 1.8 million which is reserved for the issuance of shares that may be used by the Board of Directors to satisfy stock purchase and option plans in favor of eligible members defined by the Board of Directors.

2004

Subsequent to the General Meeting of Shareholders held on April 13, 2004 the following share capital changes were adopted **(bold mark)**:

- Increase the conditional capital of the company to **CHF 14 million** by the issue of registered shares of CHF 5.00 each to be fully paid to be allocated as follows:
  - for a maximum amount of CHF 5.75 million which is reserved for the issuance of shares upon the exercise of option rights which were granted to the shareholders within the framework of the reduction of the share capital in 2002 which can be exercised until September 2004
  - for a maximum amount of CHF 6.0 million which is reserved for the issuance of shares upon the exercise of option rights which were granted to certain creditor banks in consideration of them waiving part of their claims in 2002 which can be exercised until July 2007
  - **for a maximum amount of CHF 2.25 million which is reserved for option rights granted to eligible members defined by the Board of Directors.**

During the year 2004:

- 50'000 registered shares were issued and fully paid for at a price of CHF 5.30 each during the 1st semester of 2004 under the 2004 Management and Board Participation Plan
- option rights for a total share capital amount of CHF 5.75 million granted to shareholders further to the 2002 capital restructuring matured in September 2004 and were not exercised
- the part of the authorised share capital in the amount of CHF 4.58 million which was resolved at the June 28, 2002 shareholders' meeting having not been used during the two years prescribed by law was cancelled. As a result there is no more authorised capital.

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

3.1 *Shares outstanding and rights attached to each class of shares*

As of December 31, 2005 the share capital consisted of 13'577'505 ordinary registered shares with a par value of CHF 5.00 each. The holders of the ordinary shares are entitled to receive dividends as declared by the meeting of shareholders and are entitled to one vote per share at the meetings of shareholders.

3.2 *Treasury shares*

In connection with the Group's financial restructuring in 2002, Tornos Holding S.A. entered into agreements with its suppliers, under which it received 168'110 of its own shares from one of its suppliers in August 2003. The Company paid CHF 0 compensation for these shares and they have been recorded pro memoria in the balance sheet. 118'110 of these treasury shares were sold during 2005 for KCHF 1'256.

As from July 12, 2004, 50'000 of these shares were loaned to a third party for market making purpose. The Group is charged a fixed fee for each share movement, any gains and losses resulting from the shares sold / bought being at the profit / expense of the third party. During the year 2005, total costs incurred totaled KCHF 43 (2004: KCHF 11).

3.3 *Conditional share capital*

The conditional share capital amounts to CHF 7.3 million. An amount of CHF 5.5 million is reserved for the issuance of shares upon exercise of option rights which were granted to certain creditor banks and creditors in consideration of them waiving part of their claims further to the restructuring in 2002. An amount of CHF 1.8 million is reserved for the issuance of shares that may be used by the Board of Directors to satisfy stock purchase and option plans in favor of eligible members defined by the Board of Directors.

3.4 *Significant shareholders*

The following shareholders or groups of shareholders held more than 5 percent of the share capital of the Company at December 31, 2005 and 2004:

	2005	2004
Management Group	10.3%	–
Günther and Helmut Rothenberger	6.7%	6.5%
Alpine Select AG	5.4%	–
Doughty Hanson Group	–	27.4%
Credit Suisse Group	–	24.7%

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

4 Stock options

In 2002, the Group granted options to the shareholders in the framework of the reduction of the share capital and to the creditor banks as compensation for their debt waiver and for granting a bridge loan. Additional options were granted to the former shareholders in connection with the settlement of a legal dispute in 2002. 93'750 of these options were exercised until December 31, 2005.

At December 31, 2005, the following options were still outstanding in this respect:

	Number of options	Expiry date
Options granted to creditor banks for waiver of loans	656'250	08.07.2007
Options granted to creditor banks for bridge loan	300'000	16.07.2007
Options granted to former shareholders	125'000	08.07.2007

Each of the options granted to the creditor banks and to the former shareholders entitles the holder to purchase one registered share for a price of CHF 6.00.

The options are secured by the conditional share capital of CHF 7.3 million (note 3.3).

5 Stock compensation plans

The General Meeting of Shareholders held on April 13, 2004 approved the issue of 450'000 conditional shares that may be used by the Board of Directors to satisfy stock purchase and option plan commitments set out below.

Share Purchase Plan

Under the 2004 Management and Board Participation Plan, eligible members selected by the Board of Directors were offered 150'000 registered shares at CHF 5.30 per share to be issued in three equal tranches over a three-year period. The purchase price was deemed equivalent to the fair market value at the date each eligible member contractually committed to purchasing the shares, hence no compensation expense has been calculated in respect of the above. As at December 31, 2005, 100'000 registered shares had been issued under the 2004 Management and Board Participation Plan. Subscriptions for 43'329 registered shares to be issued on May 1, 2006 had been received as at December 31, 2005. The 6'671 remaining shares available under this plan will be offered to the participants on May 1, 2006.

Stock Option Plan

Under the 2004 Management and Board Participation Plan, eligible members selected by the Board of Directors were issued options to purchase registered shares at a strike price of CHF 6.00 per share. The terms and conditions with respect to options granted were determined by the Board of Directors who administered these plans. Options vest over two years and remain outstanding for periods not exceeding three years. A total of 300'000 registered shares may be issued under this plan.

Compensation expense is recognised over the vesting period in accordance of the provisions of IFRS 2 "Share-based Payment". Compensation expense of KCHF 136 was recorded for the year ended December 31, 2005 (December 31, 2004 : KCHF 25). Such amounts are accrued as a liability when the expense is recognised and subsequently credited to additional paid-in capital upon exercise of the related stock options. Compensation expense arising from stock options outstanding at December 31, 2005 to be recognised in future periods amounts to KCHF 209 (December 31 2004: KCHF 50).

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

A summary of activity under the stock option plans, including weighted average exercise price, is as follows:

	Options	**Exercise price** (CHF)	**Contractual live**
Outstanding at December 31, 2003	**–**	**–**	
Granted	100'000	6.00	3 years (April 30, 2007)
Exercised	–	–	
Cancelled or expired	–	–	
Outstanding at December 31, 2004	**100'000**	**6.00**	
Exercisable at December 31, 2004	**–**	**–**	
Granted	100'000	6.00	3 years (April 30, 2008)
Exercised	–	–	
Cancelled or expired	–	–	
Outstanding at December 31, 2005	**200'000**	**6.00**	
Exercisable at December 31, 2005	**–**	**–**	

Considering the immateriality of the stock option plan, the fair value of the grants was estimated using the Black-Scholes valuation model with the following assumptions and values :

	Options granted in 2005	Options granted in 2004
Options granted	100'000	100'000
Dividend yield	–	–
Expected life	2.5 years	2.5 years
Expected volatility	25%	25%
Risk free interest rate	1.03%	1.60%
Fair value of grants per option	CHF 2.95	CHF 0.75
Expected turnover of personnel	–	–

The expected volatility used to calculate the fair value differs from the historical volatility of the Company's share price. Management considers that the historical volatility is not a reasonable basis upon which to estimate future volatility given the impact that the restructuring measures undertaken in 2002 had on both the share price and the trading volumes experienced during 2003 and 2004.

Assets pledged

On April 25, 2005 Tornos Holding S.A. entered as parent company and guarantor into a new Credit Facility

6 agreement with a new syndicate of banks. Under this agreement the syndicate of banks grants to Tornos S.A. as borrower with Tornos Holding S.A. acting as guarantor a credit facility in the aggregate of CHF 42.5 million. Of this amount, CHF 30 million can be used for advances of up to 12 months and CHF 12.5 million for current overdrafts and the issuance of bank guarantees of up to 12 months. This Credit Facility Agreement which is valid until December 31, 2007 is subject to certain conditions and financial covenants related to total debt to EBITDA and interest cover ratios as well as tangible net worth. At December 31, 2005, CHF 15 million and CHF 4.5 million were used for advances and working capital facilities respectively.

In accordance with this Credit Facility Agreement, the Company and each Director holding shares in Tornos S.A., Moutier pledged all shares in the latter, free of any security interest or any other encumbrance in favour of the new syndicate of banks as security for the due and punctual fulfillment of the obligations of both Tornos S.A., Moutier, as the borrower, and Tornos Holding S.A., Moutier as the Parent.

PROPOSED APPROPRIATION OF AVAILABLE EARNINGS

In thousands of CHF

For the years ended December 31,	**2005**	**2004**
Retained earnings brought forward	529	529
Net income for the year	834	–
Available earnings	**1’363**	**529**

The Board of Directors proposes to the General Meeting of Shareholders the following appropriation of available earnings:

Available earnings	1’363	
To be carried forward	**1’363**	

TORNOS

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